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No. 809

# In the Supreme Court of the United States

OCTOBER TERM, 1967

INTERSTATE COMMERCE COMMISSION, APPELLANT

*v.*

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

*ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY*

## BRIEF FOR THE INTERSTATE COMMERCE COMMISSION

ROBERT W. GINNANE,
*General Counsel,*
FRITZ R. KAHN,
*Deputy General Counsel,*
LEONARD S. GOODMAN,
*Associate General Counsel,*
*Interstate Commerce Commission,*
*Washington, D.C. 20423.*

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## BRIEF FOR THE INTERSTATE COMMERCE COMMISSION

### OPINIONS BELOW

The opinion of the district court (A. 12–32) is reported at 268 F. Supp. 71. The opinion of the entire Commission (A. 60–72) is reported at 326 I.C.C. 77; an earlier opinion of the Commission, Division 2 (A. 35–59) is reported at 323 I.C.C. 758.

### JURISDICTION

The judgment of the three-judge district court (A. 32–33) was entered on May 15, 1967, and the Commission filed its notice of appeal on July 13, 1967. The appeal was docketed in this Court on November 9, 1967, and jurisdiction was noted on January 15, 1968.

The jurisdiction of this Court to review the judgment of the district court on direct appeal is con-

ferred by 28 U.S.C. 1253 and 2101(b). *American Trucking Associations, Inc.* v. *Atchison, Topeka and Santa Fe Ry. Co.*, 387 U.S. 397 (1967); *American Trucking Associations, Inc.* v. *United States*, 364 U.S. 1 (1960).

## STATUTE INVOLVED

Section 15a of the Interstate Commerce Act, 49 U.S.C. 15a, provides in its entirety:

> (1) When used in this section the term "rates" means rates, fares, and charges, and all classifications, regulations, and practices relating thereto.
>
> (2) In the exercise of its power to prescribe just and reasonable rates the Commission shall give due consideration, among other factors, to the effect of rates on the movement of traffic by the carrier or carriers for which the rates are prescribed; to the need, in the public interest, of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service; and to the need of revenue sufficient to enable the carriers, under honest, economical, and efficient management to provide such service.
>
> (3) In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to

the objectives of the national transportation policy declared in this Act.

The National Transportation Policy, 49 U.S.C. preceding §§ 1, 301, 901 and 1001, provides:

> It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions;—all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

## QUESTIONS PRESENTED

Appellee railroads proposed a substantially reduced rate to capture bargeline traffic. The reduced rate was filed at precisely the level of the existing barge-truck

rate. The reduced rate exceeded the railroads' out-of-pocket costs, but was less than their fully-distributed costs; the rate was also less than the fully-distributed costs of the bargelines. The Commission ordered the reduced rate canceled on the grounds that it impinged upon the ability of the bargelines to assert and maintain their inherent cost advantage. The district court reversed the Commission's order. The questions presented are:

1. Whether, in view of Section 15a(3) of the Interstate Commerce Act and the National Transportation Policy, the Commission was precluded from ordering the rail rate canceled simply because the rate exceeded the railroads' out-of-pocket costs of transporting the traffic.

2. Whether the Commission's reliance on a comparison of the fully-distributed costs of each competing mode of transportation in order to recognize and preserve the inherent advantages of the low-cost mode was legally permissible and justified in the circumstances of the present case.

## STATEMENT

For nearly 10 years the commodity ingot molds, which are iron forms in which molten steel is cast, moved almost exclusively by bargeline and truck from Pittsburgh, Pennsylvania, to Steelton, Kentucky (A. 36–37, 61). The Pennsylvania Railroad Company (now the Pennsylvania New York Central Transportation Company) and the Louisville and Nashville Railroad Company proposed to reduce their rate of $11.86 per ton on the ingot molds and stools moving between

these points by more than one-half (to $5.11) to capture this traffic. The Commission suspended the proposed reduction on petition of the bargelines (A. 36), and both the railroads and the bargelines presented evidence at the ensuing hearings. The rate became effective by operation of law when the Commission failed to conclude the proceeding within the seven-month suspension period authorized by the statute.[1]

The Commission accepted each party's computation of its own costs at the hearings. The railroads computed their "long-term out-of-pocket costs" at $4.69 per ton (A. 63). These costs were computed as follows: a witness for the L. & N. presented evidence of its costs of operating in the Southern Region, reduced by five percent to reflect the lesser costs of switching and loss and damage claims on ingot mold traffic (Exhibits 7, 8); a witness for the Pennsylvania also testified that its costs would approximate that carrier's Eastern District costs after minor adjustment (Exhibits 11, 12). The two computations were then combined for a composite "long-term out-of-pocket" cost of both railroads (Exhibit 9).[2] The railroads further computed their full cost of moving this traffic, *i.e.*, their "fully-distributed costs," of $7.59

[1] Section 15(7) of the Interstate Commerce Act, 49 U.S.C. 15(7).

[2] The long-term out-of-pocket costs were computed under a Commission-sponsored formula which generally holds that 80 percent of rail operating expenses, rents and taxes are out-of-pocket and will vary with the traffic. To this is added a return element of 4 percent on a portion of the investment (all the equipment and 50 percent of the road property), and this element was apportioned to each ton of the present traffic.

using the same Eastern District and Southern Region averages.[3]

The water carriers, based on the costs of the Mississippi Valley Barge Line Company, computed their fully-distributed costs to be $5.19.[4] This figure was just above their out-of-pocket costs.[5] Since the bargelines had no right-of-way costs, none were included in the foregoing computation.[6]

The railroads then presented the testimony of four economists:

1. Professor William J. Baumol led off by stating his "fundamental conclusion" that in setting price floors only the incremental costs of the carriers proposing the rate are relevant.[7] He would defer to the "profit motive" of the railroads (A. 90). He expressly rejected the cost of the low cost carrier as a standard

[3] A. 63, 199.

[4] The full cost figure included barge full costs of $3.40, a barge-to-truck transfer charge of 95 cents, and a for-hire truck charge of 84 cents (A. 61, 63, 166, 173).

[5] The formula for the computation of bargeline costs, Barge Form C (Exhibit 24 in the present record), states in its Explanatory Statement, "In the absence of studies showing the actual portion which out-of-pocket expenses are of total bargeline expenses, the operating expenses are treated in this formula in effect as though they were 100 percent out-of-pocket." And see discussion at A. 201–203, 229–230, and page 46, note 80, *infra*.

[6] The computation of bargeline costs in Exhibit 24 of record includes no user charges relating to waterways or ports (*e.g.*, p. 19). Since the water carriers here had no right-of-way costs, a witness for the water carriers stated that such costs need not be "recovered from these particular rates" (A. 209).

[7] Exhibit 37, A. 83–84.

for determining price floors of competing modes since "there is wide variation in the extent to which they made use of public facilities and thereby impose very real and significant costs on society . . ." (A. 89). Although other modes might be exempt from paying for their rights-of-way, he would not give them the benefit of their exemption in a cost comparison with the railroads. In his view, the public costs of owning and maintaining waterways must be added to barge costs in any comparison with rail costs (A. 236). He flatly disagreed with the remarks of Commissioner Freas [8] during the hearings on the 1958 Act (A. 233–34). He added (A. 90–91):

> So long as its own costs are such as to permit a profitable expansion of its traffic by means of a reduction in price, a carrier should be encouraged to undertake it regardless of the costs of its competitors.[9]

2. Professor James M. Buchanan's testimony [10] paralleled that of Prof. Baumol; counsel stipulated that Prof. Buchanan's answers on cross-examination would be the same as those of Prof. Baumol.[11] Prof. Bu-

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[8] Cited by this Court in its opinion in *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744, 755 (1963) (hereinafter the *New Haven* case).

[9] The witness objected to all cost comparisons in cases involving competition between modes (A. 84, 229–30, 236). He further objected to full cost comparisons because they would not guarantee the same profitability as out-of-pocket rates on selected traffic (A. 92, 94, 97).

[10] Exhibit 39, A. 117–129.

[11] A. 246; and see A. 119.

chanan contended that the motor carriers' cost of using the highways is to a large extent borne by the whole community, and noted that bargelines do not pay user charges for their waterways; but like Prof. Baumol he would merely increase those carriers' costs to offset any such advantages (A. 119–20). He rejected the thought that rail freight rates should be based on the costs of the low cost carrier as "backward reasoning" and "perverted logic" (A. 128).

3. Professor Richard B. Heflebower testified in a similar vein,[12] and the parties stipulated that he would respond to questions like Prof. Baumol (A. 247). He stressed what he termed the "excess capacity" of the railroads occasioned by the need to maintain heavy roadbeds for heavy trains or due to "an earlier optimistic forecast of traffic volume" (A. 132). For "the optimal use of resources in the railroad industry", railroads must charge at a long-term out-of-pocket level on some traffic (A. 134). In his view, whichever mode has the lower incremental cost[13] would be the "more efficient" (*ibid.*). However, such costs of other modes must add in "the *social* incremental costs of the publicly-owned facilities—including, for example, highways, waterways, and airports" (A. 135) (Emphasis his).

4. Finally, Dr. Ford K. Edwards[14] under the stipulation would also have testified like Dr. Baumol.[15] Dr.

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[12] Exhibit 40, A. 129–136.

[13] The railroad witnesses equated the phrase "incremental costs" to the phrase "out-of-pocket costs" as used by the Commission (A. 85).

[14] Exhibit 38, A. 137–160.

[15] A. 246, and see A. 153.

Edwards added in his direct testimony that the only pertinent consideration in this case was whether the proposed rate made the maximum contribution to railroad profit (A. 138–141). He testified that railroad pricing has no direct relation to the costs of carriage (A. 143–145). In his opinion, the presence of water competition renders out-of-pocket ratemaking by the railroads of even greater moment, for the railroads must *overcome* certain cost advantages of other modes. He explained:

> In the briefest terms, it is noted that the rails supply their own roadway plant and facilities all of which would continue irrespective of the instant traffic. In contrast, government supplies the corresponding rights of way for water carriers. The fixed costs for waterway improvements are borne by the government. No taxes are assessed water carriers for the use of waterways. Water carrier costs approach 100 percent variability.[16]

Rather than protect these cost advantages of the water carriers, the witness recommended incremental pricing to ensure the railroads' "right to participate in the haul of the traffic in issue" (A. 152).

Mr. Steiner, the economic witness for the water carriers,[17] would protect the water carriers' cost advantages. In his opinion full costs is a "realistic economic framework within which to determine low cost carriage, [and] the most-economic allocation of national resources directly purchased and used by each of the competing modes of transportation . . .

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[16] A. 151–152; and see A. 157.

[17] Exhibit 32, A. 178–189.

particularly . . . where the modes of transportation have significantly different cost structures" (A. 184–185). He further questioned the economic soundness of the railroads' diverting the movement from another mode where the shipper would not benefit from a lower rate and there would be no increase in the total volume of traffic (A. 204).

The essential questions presented to the Commission by the railroads were, (1) whether the proposed rate was "lawful from the cost standpoint if it exceeds the proponent carrier's own incremental costs," and (2) whether comparing costs to determine which mode has a cost advantage would be "a futile exercise, uncalled for by the law, and destructive of sound economic principles."[18]

The division held that it would adhere to the use of full costs "as the standard for determining the inherent advantage of low cost in the situation presented," after citing *Grain in Multiple Car Shipments—River Crossings to South,* 321 I.C.C. 582 (1963), which along with the second report in that case (325 I.C.C. 752) is hereinafter referred to as the *Grain* case. It then held that the water carriers' inherent cost advantage was lost, when the bargelines priced their service a few cents below their own full costs (A. 41–42); and it accordingly approved the railroads' reduced rate.

Both parties petitioned for reconsideration of the division's report. The railroads repeated their earlier arguments that the proposed rate was lawful from a

[18] Brief of the Respondent Railroads, filed with the Commission on June 10, 1964, page 28.

cost standpoint when it exceeded the proponent carrier's out-of-pocket costs, and alleged that any comparison of costs with another mode would be "almost certain of failure" and "self-defeating." One reason cited by the railroads for their objection to "unrealistic cost comparisons" was that "one of the compared modes may have a large part of its facilities provided by the Government, either without cost to it or at charges which are far less than compensatory to the Government. The other [mode] provides all of its equipment and facilities without Government assistance." [19]

The entire Commission in a report and order of November 9, 1965, agreed with the division's cost findings (A. 63).[20] It further agreed with the division's reading of the earlier *Grain* case that fully-distributed costs had been the applicable standard in measuring inherent cost advantages (A. 65–66). It stated that no showing had been made that such standard was inappropriate or inadequate (A. 67); nor had the railroads shown they were the more efficient competitors (A. 67–68). The Commission referred to other proceedings involving rail-barge competition in which it had used a full-cost comparison. It stated that "a radical departure from the fully-distributed cost norm as urged by the respondents would not be justified on

[19] Petition of the Respondent Railroads for Reconsideration and Modification of the Report of Division 2, filed with the Commission on March 19, 1965, page 8.

[20] The division had also stated that the record did not show the costs of the Mississippi Valley Barge Company to be representative of all barge protestants (A. 39); the entire Commission reversed this particular finding and accepted Mississippi's costs as typical for purposes of the present case (A. 63).

the limited record here before us * * *'' (A. 70). The Commission reversed the division's approval of the reduced rate, finding that the cost advantage of barge-lines, established in many proceedings, cannot be lost by the accidental creation of a rate below the barges' full costs (A. 68–69). Hence, the Commission ordered the rate canceled (A. 80) as infringing upon "the ability of the barge-truck mode competitively to assert its inherent cost advantage" (A. 71). Three members of the Commission dissented (A. 72–80).

The district court reversed the Commission in an opinion and judgment of May 15, 1967 (A. 12–33). The court held that the Commission had not stated a rational basis for relying on a comparison of the full costs of the two competing modes (A. 18), and that in any event the order was contrary to the statute (A. 25). On this latter ground the court stated that Congress intended that competing carriers should normally be free to offer rates that exceed their out-of-pocket costs (A. 31).

## SUMMARY OF THE ARGUMENT

1. In section 15a(3) Congress has stated that in permitting rate reductions by one mode in competition with another the Commission must not hold up the rate of the proponent merely to protect the competitor's traffic but must give due consideration to the objectives of the National Transportation Policy. The Policy in turn requires the Commission to recognize and preserve the inherent advantages of each mode, including inherent cost advantages. Such a policy is not

susceptible of fulfillment in terms of a rule of law; it requires that consideration be given to the particular circumstances of individual carriers or groups of carriers of competing modes. The lower court's opinion deprives the Commission of the discretionary authority to fashion a standard or standards for comparing costs of different modes, and substitutes the out-of-pockets costs of the proponent carrier as the only lawful standard except in extraordinary cases. The ruling undermines the on-going administrative task of recognizing and preserving inherent advantages. The court's ruling is further unrelated to preserving any specific advantages; it is propounded as a rule of law without discussion of its practical consequences in terms of administering the transportation policy. Finally, the ruling is contrary to the opinion of this Court in the *New Haven* case, which expressly holds that the task of defining and preserving cost advantages is an administrative, and not a judicial, one.

2. The district court improperly sustains the rail rate reduction solely according to a standard of what rate is the most profitable to the proponent mode of transportation. It substitutes a standard of pure economics for the statutory policy that inherent cost advantages first be recognized and then be preserved. It ignores the statutory framework of fair and impartial regulation of the competition between different modes of transportation, and improperly holds that the Act and the Policy permit a carrier to establish rates that are compensatory from its own revenue

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standpoint without regard to the inherent cost advantages of competing modes.

3. From the earliest period of the Interstate Commerce Act, Congress has evinced a purpose to prevent out-of-pocket pricing by the railroads that had as its purpose the destruction of competing modes. First in section 4 of the Act, then in the Motor Carrier Act of 1935, and finally in section 15a(3) and the National Transportation Policy, Congress sought to protect the low-cost advantages of competing modes of transportation from out-of-pocket rates. One such advantage of the competing water carriers repeatedly recognized, and apparent on the face of the present record, is the absence of right-of-way costs. Congress on advice of the Commission never enacted any cost measure that should govern all competitive cases as a matter of law; nevertheless, it made clear that any measure should recognize and preserve the competitors' cost advantages, such as the absence of right-of-way costs.

4. The full cost standard here employed by the Commission does recognize the long established cost advantages inherent in the operations of the inland water carriers of this country, such as the absence of right-of-way costs in their cost computations. This advantage had been described in detail in the *Grain* case, cited by both the division and the entire Commission, and had in fact been recognized on this record by the railroad witnesses. The witnesses only sought to avoid the necessary consequence of this recognition under the statute, *i.e.*, the "preservation" of such inherent advantages. The Commission on the basis of its precedents and the opinion of this Court in *New Haven*

properly refused to permit the railroads to avoid the cost comparison altogether or to make the cost comparison in a manner that would ignore the admittedly inherent cost advantages of the bargelines. Its decision to employ a full cost standard was lawful on the record before it and was supported by a plainly rational basis.

## ARGUMENT

### I. THE DECISION BELOW INTERFERES WITH THE DISCRETIONARY AUTHORITY OF THE COMMISSION RECOGNIZED BY THIS COURT IN THE NEW HAVEN CASE TO PRESERVE INHERENT COST ADVANTAGES OF COMPETING MODES OF TRANSPORTATION

The district court engrafts upon the statute a uniform measure of the inherent cost advantage as between two competing modes of transportation. Its rule of law withdraws the administrative discretion to measure inherent cost advantages.[21] The lower court holds that the Commission's order is "not in accordance with law," since it allegedly "failed to take account of the Congressional intent that carriers should normally be free to offer rates which are compensatory, *i.e.*, above relevant out-of-pocket costs" (A. 31; 268 F. Supp. at 82). Congress has allegedly expressed "a clear intent that reduced compensatory rates

[21] It is true that the lower court held out the possibility of another standard in unspecified "situations" (A. 31; 268 F. Supp. at 82). As the Solicitor General has stated in the Memorandum filed in this Court, the rule of law laid down by the lower court "prohibits the Commission, except in extraordinary situations, from using fully distributed costs as the criterion for determining inherent advantage between competing modes" (p. 4).

should normally be allowed" (A. 31–32; 268 F. Supp. at 83).

The decision below leaves no room for the Commission to respond to the facts of a given case. We later show that the lower court erred in its reading of the legislative intent, that Congress in fact favored a fully-distributed cost standard,[22] if it favored any standard at all, and that it made a conscious choice to adopt no standard as a matter of law. Here we note the lower court improperly adopts a rule of law where the statute intends a role for the exercise of administrative discretion.

The statute prescribes no formula to determine or measure an inherent cost advantage. As this Court recognized in *New Haven,* the question is one of "utility" in "comparing the costs of two or more modes of transportation" (372 U.S. at 760, note 13). Hence, the proper measure of the cost advantage is an administrative question rather than a question of law. As this Court added in *New Haven,* "It is not for us to make this determination at this stage, or to decide in advance precisely how either carrier's inherent advantages should be measured or protected" (at 760). All such questions "should be left for initial resolution to the Commission's informed judgment" (at 761).

In the *New Haven* case, the Department of Justice stated the position in its separate brief to this Court that under section 15a(3) and the National Transportation Policy, the Commission may establish differen-

[22] Similarily, this Court approved fully-distributed costs as one of the legally permissible standards in *New Haven,* discussed at pp. 47–48, *infra.*

tials "to enable the low-cost carrier to recover its fully distributed costs for the service in question." In its view, "a proposed rate will destroy, or at least impair, that cost advantage . . . when the low-cost carrier is unable to fix a rate which . . . covers its fully distributed costs . . ." [23] The Department's considered solution in the *New Haven* case, reached after a carefully detailed discussion of the many facets of intermodal competition, was that an impairment of an inherent cost advantage occurs, "when the low-cost carrier is unable to fix a rate which (a) covers its fully distributed costs and (b) affords it a rate advantage (as against the high-cost carrier) which is no less than the cost differential (measured in terms of fully distributed costs) between the two modes" [24] In terms of the present facts, the Department then would have required the railroads to price their present service at no lower than $7.51, or $2.40 (the difference between the full costs of the two modes) *higher* than the present barge-truck rate.[25]

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[23] Brief for the United States in Nos. 108 *et al.*, Oct. Term 1962 (herein New Haven Brief), at 21, 40–41. In their "Corrected Brief," filed in the district court in this case, the Department claimed that the New Haven Brief only "recommended, in passing, a manner by which this protection might be accomplished."

[24] New Haven Brief, at p. 15, repeated at 40–41.

[25] In stark contrast to its New Haven Brief, the Department's Antitrust Division filed a brief in the district court in the present case urging that the determination of inherent advantages should be left to the "judgment of the marketplace, as is normally the case in a free enterprise system," and that a comparison of cost and service advantages is "not a relevant element of the rate proceedings." They espoused the railroads' position that such mode should be permitted to "achieve maximum returns." Brief of the United States in the district court, pp. 26, 32.

The Commission adopted no rigid differential in the present case, and hence its standard favored the railroads more than did the Department's standard in *New Haven*. What is most important, however, is that the decision below forecloses any further administrative refinement of the standard. The district court overlooked the Commission's basic function under the National Transportation Policy, under which the Commission became, "not merely the regulator, but to some extent the coordinator of different modes of transportation." With the passage of the Transportation Act of 1940, 54 Stat. 899, the Commission was charged with seeing that the various modes "are coordinated in accordance with the national transportation policy . . . [which] was designed to eliminate destructive competition not only within each form but also between or among the different forms of carriage." *Eastern-Central Motor Carriers Assn.* v. *United States*, 321 U.S. 194, 205–206 (1944). The decision below improperly replaces the administrative function with a rule of law.

II. THE DISTRICT COURT IMPROPERLY AUTHORIZES A RATE REDUCTION SOLELY ACCORDING TO THE STANDARD OF WHAT RATE IS THE MOST PROFITABLE TO THE PROPONENT MODE

The district court used an out-of-pocket standard only to remove "a restriction on competition" and to enable carriers to "be free to offer rates which are compensatory."[26] The decision below does not otherwise further our understanding of what "inherent advantages" the National Transportation Policy is de-

[26] A. 30–31; 268 F. Supp. at 82.

signed to protect. The decision does not rest on any analysis of water or rail transportation service, and does not consider any inherent element of their respective services that gives one mode a cost advantage over the other. Its interpretation of the statute rests entirely on the assumption that "inherent advantages" *means* the ability of one mode of transportation to add to its own profit by competing with another mode.

The railroads identified no other inherent cost advantage that would be reflected in the proposed rates. They premised their case solely on the fact that basing their rates on out-of-pocket costs permitted them to maximize their own profit. They argued they were the more "efficient" mode of transportation under the transportation policy. The Commission disagreed; the ability to make more money while avoiding an out-of-pocket loss does not show superior efficiency (A. 67–68).

The railroads in this connection oftentimes referred to their alleged "'excess capacity,"[27] which occasioned their using out-of-pocket rates. Such excess by itself would seem to indicate that the railroads were inherently inefficient, rather than more efficient, in any comparison with the bargelines, and the Commission summarily rejected their claim of superior efficiency.

The witnesses appearing for the railroads could not agree among themselves as to whether they were urging a formula that made the most efficient use of society's resources,[28] or only the most "optimal use of

[27] Exh. 38, p. 13, A. 146–47; Exh. 39, pp. 14, 15, A. 126; Exh. 40, pp. 4–6, A. 131–33.

[28] *E.g.* Exh. 37, pp. 25–26, A. 98; Exh. 39, pp. 5, 7, A. 119–20, 121.

resources in the railroad industry."[29] To the extent they argued the latter, of course, they advocated what the district court adopted, a rule premised on what is profitable to the proponent of the rate. To the extent they addressed themselves to society's resources, their argument merely avoided the cost advantage enjoyed by the bargelines. An argument regarding the best use of society's resources is more pertinent to consideration by the Congress of the question whether expenditures for waterways should be made. Since the expenditures have been made, and since "society's resources" include the fully-developed waterways, the rail economists never explain how shifting the traffic away from these waterways to the railroads is the most efficient use of all available resources.

The district court states that Congress intended the Commission to adhere to the standard it had established in the *New Automobiles* case,[30] which in its view involved "essentially" a "comparison . . . of the two modes' out-of-pocket costs."[31] However, as this Court set forth in *New Haven,* the "theme," the "particular passage in the *New Automobiles* decision which the [Senate] Committee endorsed," was a passage condemning the division of traffic merely to protect competing modes; the thrust of *New Automobiles* is en-

[29] *E.g.* Exh. 40, p. 8, A. 134; and see Exh. 37, Att. p. 9, A. 415.

[30] *New Automobiles in Interstate Commerce*, 259 I.C.C. 475 (1945).

[31] A. 29; 268 F. Supp. at 81.

tirely unrelated to the determination of comparative cost advantages.[32]

The district court states that in its view "the chief thrust" of the 1958 amendment to section 15a(3) was "to encourage competitive ratemaking." But its support for this undisputed conclusion also lays emphasis on the "inherent advantages" of each mode, without mention of out-of-pocket pricing.[33]

Section 15a(3) on its face prescribes a framework for administrative regulation of intermodal competition. As this Court stated in *New Haven*, the section relates "to the role of the Commission in its task of overseeing competition among different modes of transportation" (372 U.S. at 746). It relates to this role through its specific reference back to the National Transportation Policy (at 758). The "principal reason" for the reference back to the Policy in section 15a(3) was "to emphasize the power of the Commission to prevent the railroads from destroying or impairing the inherent advantages of other modes" (*ibid.*). Thus, the Commission's task does not end with a finding that under proposed rates that compete with other modes the railroads will maximize their profit.

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[32] See 372 U.S. at 756–57. To be sure the Commission in *New Automobiles* compared costs. But the only issue presented for decision was created by the motor carrier position that "the railroads should in no instance go below the fully distributed rail costs or the truck rates * * * to save the revenues of all forms of transportation from further depletion, and to prevent the extinction of the motor common carriers" (259 I.C.C. at 530).

[33] A. 28; 268 F. Supp. at 81.

In *New Haven*, this Court specifically rejected the theory that the task of preserving inherent advantages required only a decision regarding how one mode would make greater profit. It specifically noted that the Commission might employ some standard other than fully-distributed or out-of-pocket costs, since "the utility of the concepts . . . may be limited" to a *different* area, "the area in which they have traditionally been employed—that of determining the reasonableness of a rate from the standpoint of a carrier's own revenue requirements" (at 760, note 13). This Court stated in *New Haven* that once "a carrier shows a proposed rate to be just and reasonable from the standpoint of its own revenue requirements," the proceeding does not end; rather, "it is for a protesting carrier who relies on a claim of inherent cost advantage to bear the burden of persuading the Commission of the existence of that advantage" (at 760, note 12).

Similarly in *Eastern-Central Motor Carrier Assn.* v. *United States*, 321 U.S. 194 (1944), this Court flatly rejected the argument accepted by the district court here that considerations of competitive necessity (or one mode's self-inerest) must as a matter of law be given controlling weight by the Commission. Under the statutory policy, the choice of a predominant factor would be "for the Commission to make," and whether in any case one mode's self-interest must control is "doubtful" (*Id.* at 210–211).

Without any factual premise for the standard employed, and with a measure that fulfills only the criterion of assuring the railroads greater profit, the lower court awards the relief that years of railroad effort before Congress failed to achieve. This Court in *New Haven* detailed the battle that raged before Congress in

the Fifties and that culminated in the Transportation Act of 1958, 72 Stat. 568. Congress rejected the comparable effort of the railroads, there embodied in the "three-shall-nots", to open up rail-water competition to any rail rate that favored the railroad (see 372 U.S. at 753–58). Congress enacted legislation that contained, (1) a renewed admonition to the Commission not to hold rail rates up *merely* to make certain that water carriers shared in the traffic, and (2) an equally strong admonition that the Commission should protect the "inherent advantages" of water transportation from being impaired or destroyed by rail rate reductions. The lower court's rule of law departs from the legislation in adopting a standard that relates to the enhancement of railroad profit as the touchstone of the transportation policy.

## III. THE LEGISLATIVE HISTORY OF SECTION 15A AND THE NATIONAL TRANSPORTATION POLICY SHOWS THAT CONGRESS INTENDED A COMPARISON OF RAIL AND WATER CARRIER COSTS, SUCH AS FULLY-DISTRIBUTED COSTS, THAT WOULD PROTECT KNOWN INHERENT COST ADVANTAGES OF WATER TRANSPORTATION

Before discussing why the Commission continued in this proceeding to compare the fully-distributed costs of the competing modes,[34] it may be well to set forth the legislative history of section 15a(3) and the National Transportation Policy. With this as background, we will then discuss in our last section the findings of the Commission as they fulfill the Congressional objective.

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[34] Other proceedings in which the Commission used this test following this Court's decision in *New Haven* are described at pages 48–49, *infra*.

Before 1887, the railroads with successive rate cuts succeeded in driving the water carriers from the inland waterways and greatly weakened the intercoastal carriers.[35] Just before the First World War, the railroads further succeeded in driving all independent boats from the through lake-and-rail transportation, thereby occasioning further legislation greatly restricting railroad control of water carriers.[36] As a consequence, for over 80 years Congress has imposed restrictions on the filing of rates by railroads if such rates threaten the survival of water carriers. Our review of this struggle is limited to a consideration of its effect on the development of the ratemaking standards of the Interstate Commerce Act.

1. *Prior to 1935.* In this period the significant water-rail controversies centered over section 4 of the Act, and the extent to which the railroads might charge more for a shorter haul than for the longer haul that competed with water carriers. The original Section 4 prohibited a greater charge for the shorter haul than for the longer haul unless the Commission specifically authorized a departure from the general rule.[37] In the Transportation Act of 1920, 41 Stat. 480, Congress amended Section 4 to its present wording, to

[35] See, *e.g.*, concurring opinion of Commissioner Eastman in *Petroleum Products from New Orleans, La., Group*, 194 I.C.C. 31, 44–45 (1933).

[36] The Panama Canal Act of 1912, 37 Stat. 566, 49 U.S.C. § 5(14), prohibited all rail control of water lines operated through the Canal and allowed control of other lines to continue only upon findings and an order of the Commission. An application for such an order was denied in *Lake Line Applications Under Panama Canal Act*, 33 I.C.C. 699 (1915).

[37] Act to Regulate Commerce, 1887, section 4, 24 Stat. 380.

prohibit "the establishment of any charge to or from the more distant point that is not reasonably compensatory for the service performed." [38]

On its face, the 1920 Act required more than a showing of a compensatory rate to meet the new requirements of Section 4.[39] The rate, even though compensatory to the carrier proposing it, must have a reasonable purpose and effect. In the first case to arise under the 1920 Act involving Section 4, the Commission construed the phrase "reasonably compensatory" as a mandate to pursue "a less liberal policy in dealing with departures from the long-and-short-haul rule"; the phrase implied that the proposed rate must,

> (1) cover and more than cover the extra or additional expenses incurred in handling the traffic to which it applies; (2) be no lower than necessary to meet existing competition; (3) not

[38] In addition, Congress stated the policy in section 500 of the 1920 Act "to foster and preserve in full vigor both rail and water transportation" (41 Stat. 499). In the Mann-Elkins Act of 1910, 36 Stat. 547, Congress earlier added a provision to section 4 designed, as this Court stated in *Skinner & Eddy Corp.* v. *United States*, 249 U.S. 557, 567 (1919), "to prevent the railroads from killing water competition by making excessively low rates." In an era before Congress delegated authority to the Commission to fix minimum rates, the 1910 amendment penalized a railroad that succeeded in eliminating water competition; it provided that such railroad "shall not be permitted to increase such rates unless after hearing by the Commission it shall be found that such proposed increase rests upon changed conditions other than the elimination of water competition."

[39] Prior to 1920, the cost standard under Section 4 was whether the proposed rates exceeded out-of-pocket costs. *E.g.*, see *Reopening Fourth Section Application*, 40 I.C.C. 35, 40 (1916).

> be so low as to threaten the extinction of legitimate competition by water carriers; and (4) not impose an undue burden on other traffic or jeopardize the appropriate return on the value of carrier property generally . . .

*Transcontinental Cases of 1922*, 74 I.C.C. 48, 71 (1922). This formulation of the standards applicable to a "reasonably compensatory" rate has been a consistent and continuous policy,[40] sustained by three-judge courts,[41] and ratified by Congress in 1935.[42]

From 1920 to 1940, Congress enacted no further ratemaking standard to govern cases involving water and rail competition. Section 15a throughout this period was limited to considerations affecting the reasonableness of the return to the carriers and of the

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[40] See *Export and Import Rates*, 169 I.C.C. 13, 53 (1930); *Newsprint Paper From Tenn. and Ala. to Baton Rouge, La.*, 315 I.C.C. 117, 122 (1961); *Steel Bars, Lemont, Ill., to Iowa, Kans., Mo., Minn. & Nebr.*, 319 I.C.C. 292, 305 (1963). The Commission extends to section 4 cases the ruling of this Court in *New Haven* that rates exceeding the proponent's full costs are reasonable and cannot be disapproved on account of their effect on a competing modes' traffic or revenues. *E.g.*, *Steel Bars* case, *supra*.

[41] *Igert* v. *United States*, 211 F. Supp. 42 (N.D. Ala. 1962); *A. L. Mechling Barge Lines, Inc.* v. *United States*, 209 F. Supp. 744, 749 (N.D. Ill. 1962), rev'd on other grounds, 376 U.S. 375; *Dixie Carriers* v. *United States*, 143 F. Supp. 844, 853 note 16 (S.D. Tex. 1956).

[42] Bills passed the House in both the 74th and 75th Congresses to abolish the long-and-short haul clause of Section 4, and one was reported favorably by the Senate Committee on Interstate Commerce, on the grounds that, "It is seen by this interpretation in *Transcontinental Cases of 1922*, the Commission has in fact legislated upon the subject * * *." See S. Rep. 1768, 75th Cong., 3d Sess., p. 7. The bill was never enacted, since the Senate refused to act. For Senator Wheeler's role in blocking the repeal of the section, see 84 Cong. Rec. 5874, 5949.

rates to the shipping public. Congress relied primarily upon the Commission's consistent administration of section 4 to ensure the survival of water competition.

2. *Motor Carrier Act of 1935.* Congress adopted a different approach to the question of the proper scope of rate competition between railroads and motor carriers. The Motor Carrier Act included a more specific ratemaking rule than in section 4. In section 216(i), 49 Stat. 558, the Commission was required to give due consideration, among other things, "to the *inherent advantages* of transportation by such carriers [and] to the effect of rates upon the movement of traffic by such carriers." (Emphasis added).

Section 216(i), as introduced, referred to the "circumstances and conditions peculiar to transportation by such carriers." As Commissioner Eastman explained, this language was added to meet the "fear expressed on the part of the motor carriers that the Commission in its regulation of motor vehicles would not give consideration to conditions which are peculiar to motor vehicles and that it would be guided by the railroad conditions in the regulation of motor vehicles." [43]

Commissioner Eastman explained before the Senate Committee that the railroads had in recent years

[43] Hearings on H.R. 5262 and H.R. 6016 before a Subcommittee of the House Committee on Interstate and Foreign Commerce, 74th Cong., 1st Sess., p. 35 (1935). Commissioner Eastman added before the Senate Committee that this language was added to allay fears that the Commission would regulate other modes "along railroad lines" or require them "to charge the same rates as the railroads charged." Hearings on S. 1629 before the Senate Committee on Inerstate Commerce, 74th Cong., 1st Sess., p. 68 (1935).

begun to cut their rates to meet motor and water competition, and such other modes had become "greatly exercised by this tendency upon the part of the railroads, and they depend upon regulation to control it." Both modes had "protested to the Commission against reductions in railroad rates and asked that they be stopped." However, "the Commission, in dealing with those situations, is handicapped by the fact that they have control only over railroad rates, and in such circumstances the natural tendency is to resolve doubts in favor of the railroads." [44]

A representative of the National Industrial Traffic League, an organization composed of a wide range of the shipping public, opposed the general reference to circumstances and conditions. While favoring regulation of motor carriers by a "slight majority" of their members, the League had many members who feared they would be "arbitrarily deprived of the natural benefits inherent in motor transportation." [45] The witness attached to his testimony a computation of the total estimated operating costs of a motor vehicle, including a return on the investment in the truck and trailer, and contrasted this cost with the existing rail freight rate structure.[46]

A later witness representing the National Cooperative Milk Producers Federation was more specific in opposing the regulation of the rates of contract motor

[44] Senate hearings, at 85.

[45] *Id.* at 271. And see testimony of the American Trucking Association's representative, at 355.

[46] *Id.* at 286-87.

carriers. He feared that the bill "may be used to compel the contract carrier to fix his rates on the same basis as the competing railroad rates." He explained (at 515):

> In the fixing of railroad rates among other things which are considered is the valuation of the railroad properties and the question of a fair return on the invested capital. It is a well-known fact that many of the roads are highly overcapitalized, have gigantic bond issues, and heavy operating charges which must be considered in fixing railroad rates. None of these things are applicable to the contract trucker. He is only interested in obtaining for his services what he considers to be their fair value.

The League's representative suggested that the rate-making section should be amended by adding, "But the Commission in the exercise of its powers shall not prescribe any rates which will unduly advantage any form of transportation and thus take from it, its natural advantage." He further suggested that the transportation policy be amended to state "that highway transportation shall be fully protected in its natural advantages."[47]

The Senate Committee reported the bill with the reference to the "inherent advantages" of motor transportation. Senator Wheeler explained that "it makes clear the policy of Congress * * * to preserve the natural advantages of such transportation * * *

[47] *Id.* at 280.

[and] that the peculiar features of transportation by truck and by bus should be taken into consideration at all times by the Interstate Commerce Commission." [48] Similarily, the Committee changed the ratemaking section to refer to "inherent advantages" in order to "require the Commission to fix truck rates on a basis that, so far as possible, reflects the costs and advantages of the motor service." [49] This purpose of the phrase received a new impetus in the Transportation Act of 1940, 54 Stat. 899, when for the first time it applied to all modes of transportation.

3. *Transportation Act of 1940.* Commissioner Eastman explained before the Senate committee hearing the bills to codify and revise the Interstate Commerce Act, that the reference to "inherent advantages" in the newly proposed National Transportation Policy would require the Commission to regulate water rates on the basis of water conditions. He noted that in the past the motor carriers had not relied on this same requirement in the Motor Carrier Act, since they could rely on their service advantages over the railroads and thereby compete effectively with the railroads.[50]

A number of witnesses opposed any regulation of the water carriers, fearing that such regulation would result in increased water and rail rates.[51] Their

[48] 79 Cong. Rec. 5650.

[49] *Id.* at 5656.

[50] Hearings on S. 1310, 2016, 1869, 2009, before the Senate Committee on Interstate Commerce, 76th Cong., 1st Sess., p. 823 (1939).

[51] *E.g.*, Herman A. Bayless, counsel for the Mississippi River System Carriers' Association, *id.* at 296; and see 529, 673.

continued references to the "cheap transportation" provided by the water carriers brought forth the remark from Senator Reed that "the only thing that is cheap about it is occasioned by the fact that the Public Treasury pays the big end of the expense * * *." [52] The Senator distinguished the three forms of domestic surface transportation in this manner: [53]

> There are three main types of transportation. One of them, the railroad, maintains its own rights-of-way. Another type is the motor-carrier group, that uses the public highways. There is a difference of opinion whether the contribution made by the motor carriers to the upkeep of highways is too much or too little, but at least it is a substantial contribution through licenses, tonnage taxes, gasoline taxes, and so forth. The third type is the inland waterways, where boats operate on a right-of-way that is furnished to them entirely without cost.

A witness representing shippers that used water transportation similarly stated, "Water transportation has only one advantage over rail transportation. It is inherently cheaper." [54] Senator Minton added, "The whole justification of a subsidy to the water carriers is the hope and expectation that the public will benefit by a better rate." [55]

The only specific suggestion presented to the Congress to protect this inherent cost advantage of the water carriers was one that would have required the Commission to make a cost comparison of the compet-

[52] *Id.*, 367.
[53] *Id.*, 523.
[54] *Id.*, 537.
[55] *Id.*, 672.

ing modes in each case on a full-cost basis.[56] When Senator Hill asked Commissioner Eastman to appraise this suggestion, the Commissioner replied that a full-cost standard "might * * * operate to the disadvantage rather than to the advantage of the water lines" in cases where the distance by water may be three times what it is by rail. He added, "as I said to the House committee, that we will go further and further in that direction," and that he opposed "any such rigid rule in the law at the present time." [57]

The statement to the House committee referred to by the Commissioner was on a bill that, among other things, would have provided that in fixing minimum rates, "the Commission shall give due consideration to the undesirability" of allowing any carrier to establish rates below "full cost * * * where such rate * * * is maintained to meet competition." [58] Commissioner Eastman responded in a letter of March 20, 1939,[59]

> The Commission fully appreciates the dangers of basing competitive rates on "out-of-pocket" costs under conditions of widespread competition, and is quite ready to believe that some such cost standard as H.R. 2531 proposes may prove, subject to reasonable limitations, to be necessary. * * * We do not believe, however, that there has yet been sufficient experience in fixing minimum rates for the purpose of pre-

[56] *Id.*, 528.

[57] *Id.*, 824.

[58] H.R. 2531, 76th Cong., 1st Sess., sec. 41.

[59] Letter from the Chairman of the Legislative Committee, Interstate Commerce Commission, to the Chairman of the Committee on Interstate and Foreign Commerce, House Committee Print, 76th Cong., 1st Sess., p. 7 (1939).

> venting destructive competition between rival types of carriers to justify Congress in laying down any specific standard for such rates. For the present we believe it to be wiser to permit the Commission to be guided in this respect by the general ratemaking rules * * * and by the general declaration of policy * * *.

Both the House and the Senate adopted the substance of the section 41 of H.R. 2531,[60] but the conference committee omitted it on the grounds it would as a matter of law "compel an increase of rates on a large part of the freight now carried by ships, highway, and rails." The conference report added, "Legitimate regulation must look to the protection of the economic advantage of each type of carrier against destructive competition of the other * * *. The other provisions of this bill afford ample protection for the preservation of the inherent advantages of water transportation." [61] Representative Lea, one of the conferees, had earlier explained that the bill "provides for the protection of the inherent advantages of water transportation as contrasted with other means of transportation. In fixing rates the water carrier is assured the advantages of the cheaper rate at which he can transport property." [62]

As this Court has stated, the purpose of Congress in 1940 was "to protect the water carrier's natural

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[60] The provision adopted by both the House and Senate authorized the Commission to permit reduced rates "so long as such rates maintain a compensatory return to the carrier or carriers after taking into consideration overhead and all other elements entering into the cost." S. 2009, 76th Cong., 3d Sess.

[61] H. Rep. 2016, 76th Cong., 3d Sess., pp. 81–82 (1940).

[62] 84 Cong. Rec. 9862.

advantages." *Interstate Commerce Commission* v. *Mechling,* 330 U.S. 567, 576 (1947). Congress had specific cost advantages in mind. For example, Senator Ellender asked Senator Wheeler, "What is the interpretation of the Senator of the phrase 'inherent advantages of each'?" Senator Wheeler replied:[63]

> When the bill speaks of inherent advantages of the shipping interests, it refers to carriers which can transport at a cheaper rate because they can ship by water, by way of canals and the ocean, so they have natural advantages, and they do not have the expense of the upkeep of the rights-of-way, as railroads do.

Following the conference report, many legislators supported the Miller-Wadsworth amendment, which would have prevented *all railroad rates* from being reduced below rail full costs as a matter of law.[64] Senator Wolverton, one of the conferees, spoke against the amendment, stating that such a harsh rule of law was unnecessary. In his view,[65]

> the bill, as it stands, also fully protects one type of common carrier from unfair rate-cutting competition by another having higher costs. In the light of its provisions, the Interstate Com-

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[63] *Id.* at 6127, cited by this Court in the *Mechling* case, *supra*, 330 U.S. at 575, note 8.

[64] The amendment provided, "In order that the public at large may enjoy the benefit and economy afforded by each type of transportation, the Commission shall permit each type of carrier or carriers to reduce rates so long as such rates maintain a compensatory return to the carrier or carriers after taking into consideration overhead and all other elements entering into the cost to the carrier or carriers for the service rendered." 84 Cong. Rec. 6074.

[65] *Id.* at 10191.

> merce Commission could not permit such unfair or destructive competitive practices. Consequently, the Wadsworth amendment would contribute nothing in the way of safeguarding a carrier from unfair rate-cutting but would create an unbearable and unjust burden upon shippers [by requiring rates that are now below full costs to be raised].

He added that Congress should not adopt "a rigid rule":[66]

> Under the amendment Congress would prescribe a rigid rule to control the Interstate Commerce Commission's judgment concerning minimum rates. It has long been recognized that making freight rates by statute cannot be successful. Neither can regulation by arbitrary and inflexible ratemaking rules be successful. Flexibility and elasticity are as important to transportation pricemaking as they are to pricemaking in other industries, and rates cannot be made by formula, but must be regulated by the sound judgment of an administrative body.

The second conference report thereupon omitted the amendment, repeating the identical language it had earlier used in rejecting a full cost rule of law;[67] and Congress approved that approach.

Senator Wheeler had expressed strong disapproval of out-of-pocket pricing as between competing modes of transportation.[68] He had also stated as early as the hearings, "There could not be anything more specific" than the reference to recognizing and preserving the

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[66] *Ibid.*; and see remarks of Congressman Hinshaw, at 9966.
[67] H. Rep. 2832, 76th Cong., 3d Sess., pp. 87–88 (1940).
[68] 84 Cong. Rec. 5949.

inherent advantages of each mode of transportation.[69] As R. V. Fletcher, General Counsel of the Association of American Railroads, testified, rates of different modes, "must be fixed, if they are fixed at all, by regulating authority so as to recognize and preserve the inherent advantages of each, and one of those inherent advantages obviously would be the question of cost. If it is cheaper to move on the highways, it would be perfectly proper that there should be a difference in rates." [70]

The district court reads the Congressional rejection of a rigid full cost rule as an endorsement of an equally rigid out-of-pocket cost rule. The legislative history belies this interpretation. Congress agreed to omit the Miller-Wadsworth amendment only after assurances, (1) the amendment would operate to increase many railroad rates that were set below full costs for reasons completely unrelated to water competition, and (2) the inherent advantages of water carriers were fully protected under the wording of the National Transportation Policy. This legislative history can be read to justify the interpretation that Congress looked upon the Policy as authorizing in competitive cases the full cost rule that the Miller-Wadsworth amendment would have required throughout the railroad rate structure. The history at the very least conveys the thought that the Congress deferred to the Commission's request for a broad discretion to adopt such cost standard as experience might prove to be useful, including a full cost standard in an appro-

[69] Senate hearings, note 50 *supra*, at 223.

[70] *Id.*, 53.

priate case. The history cannot support the lower court's view that Congress turned on itself, upset the carefully constructed language of the Policy and the recognized need of so many years for protecting the inherent cost advantages of water transportation, and approved a course of unrestrained out-of-pocket rate-making by the railroads in competition with the water carriers.

4. *Transportation Act of 1958.* We submit Congress did not adopt a rule of out-of-pocket competitive rate-making; and we further submit that the railroads themselves did not believe Congress had adopted such a course, as the railroads' subsequent efforts to obtain such legislation—this time expressly rejected by Congress—demonstrate.

The Commission commenced to interpret the 1940 transportation policy as if there had been no basic change of statutory emphasis since 1920. The new language was more comparable to the 1935 act, but there had been little or no experience in regulating minimum rates as between railroads and motor carriers. Hence, the Commission drew on its experience under section 4 and defined the issues raised by a rail rate reduced to meet water competition in terms of whether the reduction was "lower than necessary to meet the competition." The Commission made no effort to define or to protect particular "inherent advantages" of water transportation. At the same time, it held in *New Automobiles in Interstate Commerce,* 259 I.C.C. 475, 538 (1945), "there appears no warrant for believing that rail rates * * * should be held up

to a particular level to preserve a motor-rate structure or vice versa."

The railroads at first sought legislation that would broadly have permitted their filing any rate above out-of-pocket costs. The history of Congress' refusal to enact the "three-shall-nots" is set forth in this Court's *New Haven* opinion, 372 U.S. at 753–55, and will not be repeated. Suffice it to say that if the railroads had thought the statute already incorporated an out-of-pocket rule, these efforts surely would not have been made by the railroads. In any event, Congress' rejection of the "three-shall-nots" convincingly shows that it did not intend either the 1940 or the 1958 acts to incorporate an out-of-pocket rule.

The railroads eventually merely drew Congress' attention to the numerous cases [71] since 1940 in which the Commission had decided a competitive rate situation in terms of whether the reduced rate was "lower than necessary to meet the competition." They then contrasted this line of cases with the holding in *New Automobiles*, where the Commission had stated it would not hold up railroad rates merely to protect the traffic of the water carriers. The railroads again requested relief comparable to the "three-shall-nots."

Congress redrew section 15a(3) to reemphasize that the Commission may step in to oversee intermodal competition if the reduced rate threatens to impair or destroy an inherent advantage of the competing mode.

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[71] See list of cases set forth in the Hearings on S. 3778 before the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., pp. 86–91.

As this Court stated in *New Haven,* "the principal reason" for the reference to the National Transportation Policy in section 15a(3) was "to emphasize the power of the Commission to prevent the railroads from destroying or impairing the inherent advantages of other modes" (372 U.S. at 758).

It should be added that during the debates over the Transportation Act, the late Senator Kefauver asked Senator Smathers, the bill's sponsor, the very question before this Court. He first noted, "A barge line competes with a railroad in all of its services; but a railroad may compete with a barge line only with respect to a very small part of the railroad service." He then asked whether it was "possible" for a railroad to make a rate to compete with a barge line "without considering its overhead," or does the transportation policy "require the railroad to take into consideration a part of its overhead in making its rate to compete with the barge line?" [72] Senator Smathers replied that the water carriers have not opposed the revised language of Section 15a(3), and "personally, I am of the opinion that they are adequately protected." The Commission may approve rail rates, "irrespective of the direct relationship it may have to another mode of transportation, so long as such rates do not result in unfair competitive practices." [73]

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[72] 104 Cong. Rec. 10859–59.

[73] *Id.* at 10859. The Department of Justice interpreted this colloquy in its *New Haven* Brief as showing that "Senator Smathers apparently agreed that the amendment would prohibit a rate which, by failing to return full costs, would infringe the inherent advantage of a competing lower-cost mode" (p. 34, note 13).

The lower court's decision contradicts the basic purpose of the 1958 legislation. Congress amended section 15a(3) to reemphasize the basic policy of recognizing and preserving inherent advantages of competing modes. The district court adopts the out-of-pocket cost standard, however, without regard to specified inherent advantages of any mode, and, as discussed earlier, runs contrary to certain known inherent cost advantages of the bargelines.

## IV. THE COMMISSION RATIONALLY CHOSE FULL COSTS OVER OUT-OF-POCKET COSTS TO RECOGNIZE AND PRESERVE THE INHERENT COST ADVANTAGES OF THE WATER CARRIERS

The evidence of record was presented in terms of a choice as between out-of-pocket costs, favored by the railroads, and fully-distributed costs, favored by the water carriers. As we shall see, the choice of the full cost measure fulfilled the basic statutory requirement that the Commission "recognize and preserve the inherent advantages of each mode."

### 1. THE WATER CARRIERS POSSESS AN INHERENT COST ADVANTAGE

The major distinction between railroads and water carriers that Congress stressed in the legislative history we have discussed was, (1) *railroads,* and hence shippers by railroad, must pay for the rail right-of-way, but (2) *water carriers,* and shippers by water, do not have this cost. The water right-of-way is a natural advantage, or its improvements are paid for by the general public, rather than by shippers as a class. The lack of a right-of-way cost was firmly recognized as an inherent cost advantage of the water

mode of transportation. Moreover, the legislative history makes clear that Congress intended the Commission to recognize and preserve at least this inherent advantage, if not others, of the water carriers.

The present record showed that the foregoing cost advantage inhered in the operations of the present water carriers. The Mississippi Valley Barge Line, a water carrier directly affected by the proposed rate reduction, operates on the Ohio River and its tributaries. Its cost computation (Exhibit 24) included no user charges relating to any waterway or port. The formula used to develop its costs (Barge Form C) recited in the initial "Explanatory Statement" that port costs would "seldom be incurred by a carrier in the movement of bargeload traffic."

Each one of the economic witnesses appearing for the railroads also recognized the inherent cost advantage that the bargelines possessed. The fact was not disputed, for each one conceded, at least in general terms, that water carriers are exempt from the right-of-way costs borne by the railroads.

The Commission, therefore, approached the choice as between full costs and out-of-pocket costs with the fact essentially admitted on this record that the water carriers did not incur right-of-way costs, and the further fact that railroads possessed heavy right-of-way costs. Indeed, the rail witnesses characterized much of the rail right-of-way cost as "excess capacity."[74] The thrust of their testimony was, as we have seen,[75] (1) that the railroads in their own interest

[74] Page 8, *supra*.

[75] Pages 6 to 9, *supra*.

must use out-of-pocket pricing to make maximum use of their capacity and thereby maximize their profits, and (2) that the railroads in using out-of-pocket pricing would successfully defeat any cost advantage of the water carriers.

2. THE CHOICE OF FULL COSTS WAS RATIONALLY SUPPORTED BY ADEQUATE FINDINGS

The Commission found that a proper cost comparison cannot ignore constant costs (A. 40–41). If the railroads ignore constant costs they thereby ignore certain costs that they must bear and that their water carrier competitors inherently do not bear. The inquiry into whether a particular rate covers out-of-pocket costs and will maximize the proponent carrier's profit does not end the Commission's task; it merely precedes the cost comparison with the competing mode.[76]

The Commission referred to its decision in the *Grain* case as an example of its recognition that the full cost standard has "generally been employed in measuring inherent cost advantages in intermodal competitive rate controversies."[77] The Commission had expressly recognized the bargelines' inherent cost advantage in the *Grain* case. "For more

[76] See A. 67–68, and this Court's *New Haven* opinion, 372 U.S. at 760, notes 12 and 13.

[77] A. 65–66. Similarly, the division in the present case also referred to the *Grain* case (A. 41). The district court states that the Commission has not consistently employed a full cost standard (A. 22; 268 F. Supp. at 78). The court erred for it cited and relied on cases in which inherent cost advantage was not an issue. For cases where the issue has been presented, see pp. 48–49, *infra*.

than a century, an essential characteristic of such [water] transportation has been its dependence upon the free use of inland waterways developed and maintained by governmental agencies" (321 I.C.C. at 590). Rather than espouse a cost comparison that ignored these costs on the rail side of the comparison, the railroads there sought to accomplish the same result by increasing the water carriers' cost by so-called "public costs." The Commission refused to adjust upward the water carriers costs, like its present refusal to adjust downward the rail costs. The Commission would not consider the costs of building and maintaining the water carriers' right-of-way, since the established Congressional policy has been to exempt inland waterway carriers from paying user charges; "Congress has concluded, in effect, that barge transportation should be encouraged and that the resulting public benefits justify the cost involved" (*ibid*).[78]

The Commission held in the *Grain* case, incorporated by reference in its present opinion, that, "Inherent advantages must be determined on the basis of costs of operation which the different modes actually bear and not on the basis of hypothetical costs which would have been incurred if the historic policy of the Congress were different" (at 592). Congress apparently recognizes that it has given a cost advantage to the water carriers in their competition with the railroads, for obviously, "the injection of such construc-

[78] The Commission added that Congress has conferred certain cost benefits on the railroads including "such items as flood control benefits, harbor improvements, occupancy of public streets, tax relief, Government loans, and various minor subventions" (321 I.C.C. at 592).

tion costs [of inland waterways] into the cost structures of the bargelines would make their traffic more susceptible to diversion by other modes" (at 590–91).

The railroads' primary argument before the Commission in the present case was that no comparison of costs should be made; but rather that the Commission should enhance their profitability and assume their greater efficiency by permitting out-of-pocket pricing to meet the water carrier rate.[79] The Commission disagreed, stating that the determination of which mode possesses an inherent cost advantage requires "a comparison of the cost advantages of two competing modes of carriage" (A. 65). As this Court had stated in *New Haven,* the Commission must pass upon the precise "measure * * * for comparing the costs of two or more modes of transportation" (372 U.S. at 760, note 13). The Commission summarily rejected the railroad contention regarding efficiency, stating they had not shown they were "the more efficient" of the two competing modes. The ability to use out-of-pocket pricing is not an inherent advantage, first, within the meaning of the transportation policy, nor secondly "in the circumstances here present" where the competing mode possesses an admitted cost advantage (A. 67–68).

Finally, the Commission underscored the importance of this traffic to the competing bargelines. Iron and steel products, which includes ingot molds, is the

[79] Similarly, the Department of Justice urged in the district court that the determination of inherent advantage should be left to the "judgment of the marketplace," and that a comparison of costs is "not a relevant element of the rate proceedings." Brief of the United States, page 26.

third most important commodity group transported in barge service, and accounts for nearly 11 percent of bargeline revenue. These products are one among the limited number (just eleven) which account for 81.45 percent of total barge revenue. Out-of-pocket pricing by the railroads in this context would, therefore, "impair the ability of a carrier [bargeline] not only to compete but to exist (A. 68).

We submit that, contrary to the statements of the district court (A. 18–24), the Commission's findings adequately support its reliance upon a full cost comparison. The task of the district court was to determine whether a rational basis supported the decision reached by the Commission. *Mississippi Valley Barge Line Co.* v. *United States,* 292 U.S. 282, 286–87 (1934). It is sufficient if the "essential basis" of the Commission's order appears, *Alabama G.S.R. Co.* v. *United States,* 340 U.S. 216, 227–28 (1951), "so that a court can satisfy itself that the Commission has performed its function." *Luckenbach S.S. Co.* v. *United States,* 122 F. Supp. 824, 828, (S.D.N.Y., 1954), aff'd 347 U.S. 984. Moreover, if satisfied that the decision of the Commission in a complicated case does not involve gross error or unfairness, the district court's review function is at an end. *Penn.-Central and N & W Inclusion Cases,* —— U.S. ——, 19 L.ed. 2d 723, 749 (1968); and see *Federal Power Commission* v. *Hope Natural Gas Co.,* 320 U.S. 591, 602–03 (1944).

The end result of the Commission's choice of full costs is fair to both sides. It succeeds in accomplishing the Congressional purpose precisely where the out-of-pocket measure fails.

The barge full costs and out-of-pocket costs are generally comparable.[80] On an out-of-pocket basis, the rail carriers are the low cost mode ($4.69 rail v. something under $5.19 barge-truck). However, an out-of-pocket comparison omits on the rail side certain constant costs, such as right-of-way costs, which the bargelines inherently do not incur. If only the constant right-of-way costs of the railroads in this proceeding (69.2 cents[81]) are added to their out-of-pocket costs ($4.69), then the bargelines become the low cost mode ($5.38 rail v. under $5.19 barge-truck). To show they were the low-cost mode, it was necessary to the rail position to exclude all their constant costs from the comparison. The Commission might have added only their constant right-of-way costs to out-of-pocket costs in the comparison and still have concluded that the rail publication of a $5.11 rate was below the cost of the low cost mode.[82] The Commission's using full costs (*i.e.*, adding all constant costs to out-of-pocket costs) made certain that the costs on the rail side of the comparison included the necessary constant costs which the bare out-of-pocket comparison ignored.

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[80] See Exhibit 24, Explanatory Statement and A. 201–203, 229–30. In *New Automobiles* the Commission stated that a water carrier's out-of-pocket costs typically will closely approximate its fully-distributed costs, "excluding only some of the general expenses" (259 I.C.C. at 508).

[81] The rail right-of-way portion of their constant costs includes road property depreciation of 2.5 cents; return on road property, freight, of 52.5 cents; and roadway and structures maintenance of 14.2 cents. See Appendix A.

[82] We, of course, do not suggest the Commission should or must use full costs in every proceeding, nor that the bargelines are favored by only the right-of-way cost advantage.

The district court questioned the reasons for using "an out-of-pocket cost comparison to determine which of the competing modes has an inherent advantage in situations where there is substantial competition from unregulated carriers," citing the *Grain* case as an example of such a comparison.[83] The court confused the role of the Commission in the presence of significant unregulated competition. The Commission has not considered "inherent advantages" in that context, because no unregulated carrier has ever presented such costs in any proceeding. Literally, the National Transportation Policy applies only to "modes of transportation subject to the provisions of this Act." Section 15a(3) on its face also applies only in cases "involving competition between carriers of different modes of transportation subject to this Act." Obviously, different considerations may be controlling in the presence of substantial unregulated competition. In any event, the present case does not pose any issue as to whether the Policy and the Act are intended to protect asserted inherent advantages of unregulated carriers.

In *New Haven,* this Court referred to the standard of full costs as an appropriate and permissible measure of the low cost advantage as between competing modes. The Court referred to a full cost comparison as "the precise example given to the Senate committee, which led to the language adopted" in the 1958 revision of Section 15a(3) (372 U.S. at 758). The Court there referred to "a case in which the railroads, by establishing on a part of their operations a com-

[83] A. 21; 268 F. Supp. at 77.

pensatory rate below their own fully distributed cost, forced a smaller competing *lower cost* mode to go below its own fully distributed cost" (*id.*, emphasis is that of the Court.)

To be sure this Court did not rule out "hard competition" where rail rates exceed rail full costs (372 U.S. at 759); and it is just such hard competition that has resulted under the standard followed by the Commission since the *New Haven* case. Where proposed rates of railroads have exceeded their fully distributed costs, the Commission has approved them, virtually regardless of the effect on competition. *E.g., Pig Iron, Buffalo, N.Y., to Chicago, Ill., and Gary, Ind.*, 321 I.C.C. 121, 128, 130 (1963); *Steel Bars Lemont Ill., to Iowa, Kans., Mo., Minn. & Nebr.*, 319 I.C.C. 292, 301, 303 (1963).

Hard competition has resulted in many areas besides iron and steel commodities since *New Haven*. For example, the Commission approved reduced rail rates on sugar from Gulf and South Atlantic ports to Ohio River crossings in July, 1959, over the protest of barge lines, upon finding the rates exceeded rail full costs. *Sugar to Ohio River Crossings*, 308 I.C.C. 167, 185–186 (1959). The barge lines in November, 1959, sought to meet the rail reductions, which led to further reductions in the rail rates. Both of the subsequent reductions were approved by the Commission upon finding they both exceeded the respective fully distributed costs of each mode, and could not be considered destructive competitive practices. *Sugar, South to Indiana, Ohio River, Intermediate Points*, 319 I.C.C. 782, 785 (1963). Only where the rail rates have been below their fully distributed costs, and be-

low the full costs of competing modes of transportation, have they been disapproved. See, *e.g., Pig Iron, Buffalo, New York, to Chicago, Ill., and Gary, Ind., supra,* at 128–130 (1963).

One of the positions asserted by the railroads before the Commission was, as the entire Commission stated, that allegedly "no reliable intermodal cost comparison can be made and none should be attempted" (A. 63).[84] As the litigation progressed through the district court,[85] the railroads embraced a cost comparison that, in lieu of adding "public costs" to the costs of the water carriers, omitted all the rail constant costs in the comparison.[86] With this partial cost comparison,

[84] *E.g.*, see testimony of witness Baumol (A. 84, 229–30, 236). In the district court, the railroads complained that the full cost comparison included a pro-rata portion of their passenger and less-than-carload deficits. However, the Commission accepted their own computation of their full costs, which included these deficits; and the objection was waived when it was not presented in the brief or petition for reconsideration before the Commission. *United States* v. *L. A. Tucker Truck Lines*, 344 U.S. 33, 36–38 (1952). Moreover, a witness for the railroads conceded that "the passenger and LCL deficits are also to be recovered" in the railroads' constant costs (Exhibit 38, p. 23; A. 154). The inclusion of these expenses in full costs was sustained by this Court in *King* v. *United States*, 344 U.S. 254, 266–67 (1952) in another rate contest. Finally, the inclusion of these deficits was not prejudicial, for they amounted to only 66.9 cents of the rail full cost of $7.59, (see Appendix A); their exclusion would have not affected the result (see page 46, *supra*).

[85] Contrast the railroads' petition for reconsideration before the Commission with their briefs below.

[86] The economic witnesses for the railroads went even further. They would either have omitted from the cost comparison a portion of the out-of-pocket right-of-way costs of the railroads (see testimony of witness Edwards, A. 158, 241); or would have adjusted the out-of-pocket costs of the water carriers upward for socalled "public costs" (*e.g.*, witness Baumol, A. 236; and witness Heflebower, A. 134–35).

the railroads sought to accomplish what they had failed to accomplish in the *Grain* case, namely a cost comparison that ignored the bargelines' inherent cost advantage of not having any right-of-way costs.

The railroad effort to defeat the bargelines' inherent cost advantage on this record by urging a cost comparison that circumvented that advantage was no less unsound than their comparable effort to circumvent such an advantage by the publication of discriminatory rates, which this Court condemned in *Interstate Commerce Commission* v. *Mechling*, 330 U.S. 567 (1947). As this Court noted, the grain rates into Chicago were cheaper by barge than by rail, since the bargelines were "less expensive to operate and therefore could afford to transport freight much more cheaply than railroads" (at 570). The railroads sought to defeat this inherent advantage by charging more for reshipping the grain out of Chicago when it had arrived at Chicago by barge than when it had arrived by rail. The Court reversed the Commission's approval of these rates, stating that "Congress left the Commission no discretionary power to approve any type of rates which would reduce the 'inherent advantage' of barge transportation in whole or in part" (at 579).

We submit the Commission properly relied upon a full cost comparison which on this record was the only measure that insured that the cost advantage of the bargelines would be recognized and preserved.

## CONCLUSION

The judgment of the district court should be reversed and the cause remanded with instructions to dismiss the action.

Respectfully submitted.

ROBERT W. GINNANE,
*General Counsel,*

FRITZ R. KAHN,
*Deputy General Counsel,*

LEONARD S. GOODMAN,
*Associate General Counsel,*
*Interstate Commerce Commission.*

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# APPENDIX A

*Effect of right-of-way costs and railroad deficits in a comparison of rail and bargeline full costs*

| (1) | Eastern district (2) | Southern region (3) | Total (4) |
|---|---|---|---|
| 1. *Fully distributed cost per ton* | 515.7¢ | 243.7¢ | 789.4¢ |
| 2. *Total cost*, including return, freight [1] | $2,937,490,290 | $1,139,392,535 | |
| 3. *Passenger deficit*, expenses, rents & taxes except Fed. Income | 121,433,080 | 69,169,051 | |
| 4. Return on passenger portion of road & equipment | 75,146,082 | 25,750,666 | |
| 5. Passenger deficit—Total | 196,560,162 | 94,919,717 | |
| 6. Percent passenger deficit of total freight costs. Line 5+ line 2 | 6.7% | 8.4% | |
| 7. Amount passenger deficit included in F.D. Costs. Line 1 times line 6 (all in constant costs) | 34.6¢ | 20.5¢ | 55.1¢ |
| 8. *LCL Deficit*—expenses, rents, taxes, except Fed. Income | 32,431,838 | 19,384,247 | |
| 9. Return on LCL portion of road & equipment | 6,499,020 | 4,794,656 | |
| 10. LCL deficit—Total | 38,930,858 | 24,178,903 | |
| 11. Percent LCL deficit of total freight costs. Line 10 + line 2 | 1.3% | 2.1% | |
| 12. Amount LCL deficit included in F.D. Costs. Line 1 times line 11 (all in constant costs) | 6.7¢ | 5.1¢ | 11.8¢ |
| 13. *Road property—depreciation* | 49,204,136 | 18,640,994 | |
| 14. Normalized depreciation of amortized road property | 538,599 | 260,283 | |
| 15. Total road property depreciation in F.D. costs | 49,742,735 | 18,901,277 | |
| 16. Percent depreciation of total costs. Line 15 + line 2 | 1.69% | 1.66% | |
| 17. Amount depreciation of total costs. Line 1 times line 16 | 8.7¢ | 4.0¢ | 12.7¢ |
| 18. Amount depreciation in constant costs | 1.7 | 0.8 | 2.5¢ |
| 19. Amount depreciation in out-of-pocket costs | 7.0 | 3.2 | 10.2¢ |
| 20. *Return on road property*—freight in F.D. Costs | 394,748,923 | 166,954,686 | |
| 21. Percent return of total costs. Line 20 + line 2 | 13.44% | 14.65% | |
| 22. Amount road property return in total costs. Line 1 times 21 | 69.3¢ | 35.7¢ | 105.5¢ |
| 23. Amount road property return in constant costs | 34.7 | 17.8 | 52.5¢ |
| 24. Amount road property return in out-of-pocket costs | 34.6 | 17.9 | 52.5¢ |
| 25. *Amount of roadway & structure maintenance* in F.D. Costs (depreciation excluded) | 248,314,562 | 127,454,131 | |
| 26. Percent roadway & structure maintenance of total costs. Line 26 + line 2 | 8.45% | 11.19% | |
| 27. Amount roadway & structure maintenance in total cost. Line 1 times line 26 | 43.6¢ | 27.3¢ | 70.9¢ |
| 28. Amount roadway & structure maintenance in constant costs | 8.7 | 5.5 | 14.2¢ |
| 29. Amount roadway & structure maintenance in out-of-pocket costs | 34.9 | 21.8 | 56.7¢ |

[1] The total costs are the amounts of expenses reported by the railroads in their annual reports to the Interstate Commerce Commission and include an allowance of a 4 percent return after Federal income taxes, on the depreciated original cost of road property and equipment.



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